

PENSIONS

Should we contract out?

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Both employers and trade unions are now considering where they stand in relation to the Government's new arrangements for "graduated" pensions, and the problem of "contracting out". The new "graduated" pensions were provided for in the National Insurance Act, 1959, and the new "graduated" contributions start to be payable in April, 1961.

THE NEW GRADUATED CONTRIBUTIONS

Any approach to the question of occupational schemes must start with a careful examination of what the new national scheme does and does not provide. Its broad outline is given in the Ministry's own leaflet (N.I.III)—"A Guide to the New Graduated Pension Scheme"—available free of charge from any local insurance office. Beginning in April, 1961, there will be a minimum contribution irrespective of the amount earned and all employed persons over 18 who are earning over £9 a week will pay an additional graduated contribution based on the amount of their earnings between £9 and £15 a week. The minimum contribution will be 8/4 for men and 7/2 for women. The new contributions (which have been slightly revised since the scheme was first published) will be as follows:

TABLE A

	<i>Graduated contribution</i>	<i>Total Contributions</i>	
	s. d.	Men	Women
	s. d.	s. d.	s. d.
Present	—	9 11	8 0
New, on weekly earnings of:			
£9 or less	—	8 4	7 2
£10	11	9 3	8 1
£11	1 10	10 2	9 0
£12	2 8	11 0	9 10
£13	3 6	11 10	10 8
£14	4 4	12 8	11 6
£15 or more	5 1	13 5	12 3

At five-yearly intervals beginning in April, 1965, the contributions may be increased. The maximum increase is 5d. for a person earning £9 or less up to 9d. for a person earning £15 or more.

The earnings on which graduated contributions will be paid will in general be the same as those on which income tax is deducted by P.A.Y.E., and so will include any overtime pay, bonus, etc. They would include sick pay if it exceeded £9 a week, and also holiday pay if it is paid by the employer (unless it is money which has been set aside from the employee's pay throughout the year).

THE NEW GRADUATED PENSIONS

The standard flat-rate pension will stay at £2 10s. 0d., but will be supplemented by a graduated pension. The amount of this graduated addition will be 6d. a week for each "unit" of graduated contributions. A unit of graduated contributions will be £7 10s. for a man and £9 for a woman. Tables B and C illustrate the amounts of graduated pensions for different earnings and periods of contributions. These tables assume an average of 50 weeks' graduated contributions in a year, to allow for weeks of sickness, etc. Thus a man participating in the state scheme who is earning £13 a week will in return for 15 years' work have 9s. a week added to his standard pension of £2 10s. bringing him up to £2 19s. a week. A woman earning £11 a week will after 10 years' work receive an additional 2s. 6d. bringing her up to £2 12s. 6d. a week. And so on.

The widow of a man who has paid graduated contributions will get a graduated addition to her flat-rate retirement pension equal to one-half of the graduated pension which her husband had earned or was drawing when he died. This will be on top of any graduated pension which she herself has earned, and will be payable when she has reached 60 and has retired, or when she has reached 65.

TABLE B—WEEKLY GRADUATED PENSIONS

<i>Weekly Earnings</i>	Men				
	<i>5 years' contri- butions s. d.</i>	<i>15 years' contri- butions s. d.</i>	<i>25 years' contri- butions s. d.</i>	<i>35 years' contri- butions s. d.</i>	<i>47 years' contri- butions s. d.</i>
£ 9 or less	—	—	—	—	—
£10	1 0	2 6	4 0	5 6	7 0
£11	1 6	4 6	7 6	10 6	14 6
£12	2 0	6 6	11 0	15 6	21 0
£13	3 0	9 0	14 6	20 6	27 6
£14	3 6	11 0	18 0	25 6	34 0
£15 or more	4 0	12 6	21 0	29 6	40 0

TABLE C—WEEKLY GRADUATED PENSIONS

<i>Weekly Earnings</i>	Women				
	<i>5 years' contri- butions s. d.</i>	<i>10 years' contri- butions s. d.</i>	<i>20 years' contri- butions s. d.</i>	<i>30 years' contri- butions s. d.</i>	<i>42 years' contri- butions s. d.</i>
£ 9 or less	—	—	—	—	—
£10	6	1 6	2 6	4 0	5 6
£11	1 6	2 6	5 0	7 6	10 6
£12	2 0	3 6	7 6	11 0	15 6
£13	2 6	5 0	9 6	14 6	20 6
£14	3 0	6 0	12 0	18 0	25 6
£15 or more	3 6	7 0	14 0	21 0	29 6

CONDITIONS FOR CONTRACTING OUT

The question that is now being everywhere discussed is the relation of the new scheme to existing occupational pension schemes, and whether or not to “contract out” of the “graduated” part of the state scheme, and, if so, whether an existing occupational pension scheme requires modification. Persons who are contracted out will continue to be eligible for the basic retirement pension of £2 10s. but will forfeit the “graduated” additions.

Persons can be contracted out of the graduated part of the national scheme if their occupational scheme is considered to be adequate, which means that it must fulfil three broad requirements:

(a) that it is financially sound.

(b) that it provides a pension at or before the age of 65 (60 for women) *at least* equal to the *maximum* graduated pension which could be earned in the national scheme over the same period. This means that whatever the employee's actual earnings, the occupational scheme must provide him with additions to his standard pension which are at least as high as those for people earning £15 a week in the state scheme. What this means can be seen in the last lines of Tables B and C. Thus, to qualify for contracting-out, an occupational scheme must provide a man with a pension of at least 4s. a week for five years' contributions, 12s. 6d. a week for 15 years' and so on; it must provide a woman with 3s. 6d. a week for five years' contributions, 7s. a week for 10 years' contributions, and so on. Unless the existing occupational scheme provides pensions to at least this level for all its members, whatever their earnings, or it is proposed to bring the arrangements up to this level, contracting out is not on the agenda at all.

(c) The third main requirement is that pension rights up to this level are preserved for the employee should he leave his job. This may be done in a number of ways. For example the occupational scheme can provide the employee with a paid-up pension which is "frozen" until he reaches pension age. Or the employer will have to buy him "rights" in the state scheme so that when he enters the latter it will be as though he had, during his period of "contracted out" employment, been paying the maximum graduated contribution on £15 a week earnings. The employer will have the right to recover half the cost of this payment from any refund of contributions due to the employee under the occupational scheme.

"Contracted out" employees will continue to pay contributions at the present level—i.e., 9s. 11d. for a man and 8s. 0d. for a woman whatever their earnings.

NOTICE TO BE GIVEN BY EMPLOYER

If it is desired to contract out, the employer has to make application for a "Certificate of Non-Participation" to a Registrar appointed for this purpose. Before making application, he has to notify the employees concerned and the Registrar is unlikely to grant the Certificate if a substantial number of the employees concerned object, or he can defer issuing a certificate to allow further time for consultation between the employer and employees. If an employer takes no action or is not granted a certificate, his employees will automatically come into the national scheme.

The regulations made under the National Insurance Act provide for notice to be given in one of three forms:

- (a) by written notification to each employee.
- (b) by a written notice or notices posted up conspicuously in the employees' place of work, or
- (c) by some other method approved by the Registrar.

The employer can therefore comply with the regulations by simply sticking a notice on a noticeboard, though the only satisfactory method is obviously the first, namely, a separate written notice to every employee. The period of notice must be at least *one month*.

It should be remembered that the question of giving notice only arises if an employer wishes to contract some or all of his employees out of the state scheme. If he proposes to contract them in, no notice is necessary, though it may be very desirable that the matter should be discussed with his employees.

"Contracting out" only refers to the actual members of the occupational pension scheme concerned; employees who are not members are not affected. But in addition, an employer can apply to contract out only certain grades or categories of employees, leaving the others to contract in.

POINTS TO CONSIDER—LOWER PAID EMPLOYEES

Whether or not it is desirable to “contract out” will depend on a whole number of factors—the age and earnings of the group concerned, and what sort of pension the occupational scheme offers, whether it is a “50 - 50” scheme in which employer and employee share equal contributions, or one in which either side contributes more than 50 per cent. In considering this question the following are among the points which need to be borne in mind:

(1) By “contracting in” and participating in the state scheme lower-paid workers—i.e., men earning £10 a week or less and women earning £9 or less will secure an initial *reduction* in their weekly insurance contributions; they get hardly anything out of the state scheme in the way of a graduated pension, but if they are already members of an occupational scheme, there is no reason why this should not continue on top of the state scheme. What this would mean is that the employees should be in about the same position as they are at the moment in return for slightly lower contributions. However, this reduction in contributions will not last for ever, for the contributions may be raised in 1965 by 5d. on the minimum contribution, and then raised again three times by a minimum of 5d. each time at five-yearly intervals.

(2) If such lower-paid employees are given the opportunity to contract out it means that they will be participating in a scheme which offers a much better pension than they could earn under the state scheme (i.e., they could only get such a pension under the state scheme if they were earning £15 a week). Moreover, if they leave their job, they have the opportunity of a “frozen” pension, or pension rights at the highest level in the state scheme for the period that they were “contracted out”. But to contract out in such circumstances may mean much more in weekly contributions than would be payable under the state scheme—if the scheme is a 50 - 50 one, it will be more expensive for both employer and employee than the state

scheme. But this might not be the case, because the amount of the employees' contributions depends on how much the employer puts in. Some company schemes are non-contributory (though schemes of this kind have their disadvantages, see below) in which case the increase in contribution is limited to the difference between the 9s. 11d. which all contracted out employees must pay and the contributions for contracted in employees (see Table A). In other schemes the weekly contribution may not be very large; for example the scheme adopted by Ind Coope, which has contracted out all its employees, requires contributions of 2s. 3d. a week.

The Life Offices Association* (which considers the matter primarily from the point of view of the financial effects of contracting in or contracting out upon the employer) suggests that where practically all employees are earning £12 or less "there is no financial inducement to contract out; contracting in gives the best financial results both for employers and employees". This perhaps indicates that employers of workers earning £12 a week or less will not be particularly anxious to get their schemes "contracted out".

THE £13 PLUS PEOPLE

(3) When it comes to those earning £13 a week or more, different considerations begin to apply. If such groups of workers "contract in" to the state scheme, there is an immediate increase in contributions both for them and their employer, and this increase in contributions is heaviest where the earnings are in the £15 a week range. Table D shows the annual increase in contributions for groups of 100 employees earning respectively £13, £14 and £15 a week if they are contracted into the national scheme. It shows an annual increase in contributions for 100

* "National Insurance Act, 1959. Inter-relation with Occupational Pension Schemes. A Financial Analysis." Available from the Life Offices Association, 33 King Street, Cheapside, London, E.C.2.

men in the £13 group of £1,041 (employer and employees combined), £1,471 for the £14 group, £1,906 for the £15 or over group.

TABLE D
Annual Contribution under New and Old Scheme

	<i>Earning £13</i> £	<i>Earning £14</i> £	<i>Earning £15</i> £
Old Scheme			
100 Employees	2,579	2,579	2,579
Employer	2,145	2,145	2,145
Total	4,724	4,724	4,724
New Scheme			
100 Employees	3,055	3,270	3,488
Employer	2,710	2,925	3,142
Total	5,765	6,195	6,630
Increase			
100 Employees	476	691	909
Employer	565	780	997
Total increase	1,041	1,471	1,906

The Life Offices Association has estimated that the annual commercial cost of benefits for 100 men equal to the state scheme for the £15 per week man, would be £1,326 if the average age is 45; £1,082 if the age is 40. To this, however, must be added the cost of payments in lieu into the state scheme if employees leave their job. The Life Offices Association assumes an annual withdrawal rate of five per cent, which might cause an annual loss to the fund of £160. If this is added to the cost, the rough all over commercial cost would appear to be £1,486 a year.

From this it would seem that employees on £15 or over can either get the same benefits for less money or better benefits for the same money if they contract out of the state scheme. For the £14 a week group this is not the case on their own, but if mixed with a certain proportion of £15 a week people, contracting out might also be advantageous. The I.L.O.A. gives a

sample group of 100 men with earnings as follows: 20 at £13, 20 at £14, 60 at £15. The increase in contributions (employer and employee combined) for such a group is £1,646; if they contract out the saving is more than enough to cover the commercial cost of similar benefits in an occupational pension scheme.

(4) It will be noted from Table D that although the employees' contribution is and will continue to be greater than that of the employer, the *increase* in contributions from the employer is rather greater than the increase for the employee. It follows that if a contracted out occupational scheme is on a 50 - 50 basis, any saving for the employer will be greater than the saving for the employee.

WIDOWS AND WOMEN

(5) The national scheme provides for half the man's graduated pension to be added to the pension of his widow when he dies. This is not, however, one of the conditions which an occupational scheme has to fulfil in order to be eligible for contracting out. It should therefore be an additional factor to be borne in mind when the merits of a particular occupational scheme are being compared with the pension offered by the state scheme.

(6) Throughout this document we have in the main concentrated on men rather than women. This is because a relatively small number of women will be affected—average women's earnings are still under £7 a week, and the majority will not therefore be eligible for a state graduated pension in any case. It should be noted however that for those women who have high earnings, the *increase* in contributions under the new national scheme will be greater than that for men. Thus for a woman earning £12 a week the weekly national insurance contribution will rise from 8s. 0d. to 9s. 10d.—an increase of

1s. 10d., compared to the man's insurance contribution which will go up from 9s. 11d. to 11s. 0d., an increase of 1s. 1d. A woman earning £15 a week will have an increase of 4s. 3d. in her contribution, compared with a man's increase of 3s. 6d.

Thus for any women who are in a position to contract out the saving in contributions which would be payable into the national insurance scheme will be greater than the saving for men; and this is true both for the employer's as well as the employee's side of the contribution. It means that, other things being equal, an occupational scheme for such women should offer relatively more favourable terms in comparison with the state scheme, which indeed discriminates against women on the grounds that the earlier retirement age of 60 requires more onerous terms. Many employers hesitate over occupational schemes for women partly because of an alleged tendency to a high withdrawal rate; the new heavy expenses connected with the national insurance scheme may lead to reconsideration of the matter for higher paid women.

There is no doubt however that for all but a minority of women, the contracting out question is likely to be an academic one; their earnings are too low.

COMPANY PENSION SCHEMES

In 1957 the Government Actuary made a useful survey of occupational pension schemes, published by the Stationery Office under the title "Occupational Pension Schemes—A Survey by the Government Actuary" (1958), price 2s. The following points are of special interest:

(a) The level of pensions in the better schemes is about 1/80th of wages for each year of service, though many provide much less than this. By contrast, the pension under the state scheme is 1/150th, and this applies only to the excess of earnings over £9.

One way of comparing different schemes is to compare the *weekly* contribution with the *annual* amount of the pension per year of service. For example a man earning £15 a week will pay an additional contribution of 3s. 6d. a week under the new state scheme (13s. 5d. instead of the present 9s. 11d.) and after paying these contributions for a whole year he will be entitled to a graduated pension equal to an *annual amount* of £2. 6s. By contrast, it is quite common for private company schemes to offer an annual pension of £1 per year of service for a weekly contribution of 1s.; thus a weekly contribution of 3s. will give an annual pension per year of service of £3 which is distinctly better value for money than the state scheme for a man earning £15 a week. Table E shows weekly contributions and annual pensions per year of service in the schemes of four well-known firms for employees earning £15 a week.

TABLE E
Weekly Contributions and Annual Pensions—£15 a week

	Weekly Contribution	Annual Pension per year of service		
		s.	d.	£ s. d.
State scheme	3	6		2 6 0
Company Scheme A	3	0		3 0 0
B	5	0		5 0 0
C	7	6		7 16 0
D	7	6		9 15 0

This table shows that, whereas scheme A is an improvement on the state scheme, schemes B and C offer distinctly better pensions in return for higher contributions and are typical of a great many company schemes. Scheme D is better still because here the annual pension is nearly £2 more than is offered by scheme C for the same contribution, and is in fact 1/80th of earnings. These are, of course, only four examples of company schemes of which there is an immense variety but they may help for purposes of comparison with your own scheme.

Table F is a similar table for a person earning £12 a week. Here it can be seen, as we said earlier, that the state graduated pension is not much but it is reasonably good value for money.

In schemes A and B the contributions are flat-rate irrespective of earnings and are therefore the same for earnings of £12 or £15, but in schemes C and D the contributions are proportional to earnings.

TABLE F
Weekly Contributions and Annual Pensions—£12 a week

	<i>Weekly Contribution</i>		<i>Annual Pension per year of service</i>		
	s.	d.	£	s.	d.
State scheme	1	1	1	6	0
Company scheme A	3	0	3	0	0
B	5	0	5	0	0
C	6	0	6	5	0
D	6	0	7	16	0

(b) Employees' contributions vary from nothing up to about 5 per cent of wages. At least one third of all schemes are non-contributory. This seems attractive at first sight but it may well mean that an employee who leaves his job before reaching retiring age has nothing to take with him (see (d) below).

(c) Any reasonably good occupational scheme ought to provide a widow's pension, whether the employee dies before or after reaching retiring age. Nearly all schemes for the public service and nationalised industries do so, but the majority of private schemes do not. In the absence of a widow's pension there should at least be a death benefit consisting of a lump sum payable on the death of the employee.

(d) The benefit payable to an employee who voluntarily leaves to take another job or is dismissed on account of redundancy is crucial. A contributory scheme normally provides for the payment to the withdrawing employee of the contributions he has paid into the scheme, and some schemes give him the option of a deferred annuity. A member of a non-contributory scheme has of course no contributions to take out if he leaves. Some schemes also give withdrawing employees

the benefit of the employer's contributions, but usually only in the event of redundancy, not where the employee leaves of his own free will.

Where an employer contracts out his employees he will have to provide, for any of those who leave, a deferred pension at least as good as the maximum graduated pension payable under the state scheme (as explained above). While this is better than nothing it is a very small amount. An occupational scheme which is providing retirement pensions at a much higher level than the graduated pensions under the state scheme ought surely to provide a correspondingly higher deferred pension on withdrawal. But it is likely that many employers will resist the payment of a good deferred pension, because one of the main benefits of these schemes from the employers' point of view is that an employee is very effectively tied to his job if he knows that to leave it will mean the loss of the greater part of the pension that he would obtain if he stayed with the firm until he reached retiring age.

TWO FINAL POINTS

An employer gets tax relief on his pension contributions and can therefore deduct them from profits before they are assessed for tax. Since income tax and profits tax amount to approximately 50 per cent of total profit, this means that a pension scheme only costs an employer half of what it appears to cost.

Employers have not hesitated to take advantage of the tax position to provide themselves with very generous pensions. Top hat pension schemes for directors and senior executives sometimes provide a tax-free lump sum of £40,000 or more on retirement in addition to a substantial pension.

Staff pension schemes are still much more common than works pension schemes. It has been estimated that the cost per employee of staff schemes is 700 per cent greater than for works schemes (Fabian Society pamphlet by Professor Titmuss, "The Irresponsible Society").

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